Internal Revenue Service
memorandum

CC:TL-N-2808-91
Br4:RBWeinstock

date: MAR 0 1 1991

to: District Counsel, San Francisco W:SF
Attn: Ann M. Murphy and Cynthia K. Hustad

from: Assistant Chief Counsel (Tax Litigation)

subject: [redacted]

This is in response to your request for formal tax litigation advice dated January 7, 1991 in the above-captioned case.

ISSUE

Whether Treas. Reg. § 53.4942(a)-2(b)(2)(i) is a valid regulation.

CONCLUSION

Treas. Reg. § 53.4942(a)-2(b)(2)(i) is a valid regulation which represents a reasonable interpretation of I.R.C. § 4942 in light of its language, legislative history and interrelation with other private foundation provisions.

BACKGROUND

Petitioner, [redacted] (the "Foundation"), is an exempt private non-operating foundation incorporated on [redacted] On [redacted] transferred $[redacted] in cash to the [redacted] (the "Trust") pursuant to a trust agreement under which the trustees are to distribute to the Foundation $[redacted] per year for 20 years with the remainder apportioned and distributed for the benefit of certain descendants of [redacted]

[redacted] claimed a gift tax deduction pursuant to I.R.C. § 2522(c)(2)(B) for the calendar year [redacted] in the amount of $[redacted] which is attributable to the property transferred in trust to the benefit of the Foundation. This amount was computed by applying an annuity factor to the annual amount of $[redacted] The taxable gift for [redacted] attributable to the transfer in trust was $[redacted]

The Foundation did not include the distributions from the Trust in the computations of its "minimum investment return" or "distributable amount" under I.R.C. § 4942. After examination, the Service asserted deficiencies under I.R.C. § 4942(a) and (b) based on the

Foundation's failure to make sufficient qualifying distributions attributable to the amounts received from the Trust. In the tax year ending [redacted] the Foundation made sufficient subsequent qualifying distributions which will constitute correction if respondent prevails in this litigation. The sole substantive issue in this case is whether Treas. Reg. § 53.4942(a)-2(b)(2)(i) is valid.

In its letter protesting the proposed adjustments, petitioner's counsel asserted,

[redacted]

According to petitioner, there is no such ownership interest in the trust assets until a distribution has been made to the foundation, and are only then properly includible in the determination of the minimum investment return. Petitioner then states that Congress could have specifically imposed a requirement that distributions of income from a split-interest charitable lead trust to a private foundation must be distributed in the year of receipt to public charities, but did not do this despite the extensive regulation of split-interest trusts. "Congress has stated quite clearly that the minimum required distributions from a private foundation to qualifying public charities are based (with certain modifications that are not at issue here) solely upon a percentage of the foundation's assets." Petitioner then notes that section 4942(d) "is quite clear about which adjustments can be made in a foundation's minimum investment return to arrive at the distributable amount. ... None of the adjustments pertain or relate to distributions to a foundation from a split-interest trust."

Noting that the regulation treats the assets of the split-interest trust as if they were assets of the foundation, petitioner's counsel points to the alleged inconsistency with the Code insofar as the foundation cannot own the assets of the trust and "it cannot buy, sell or encumber those assets. At the expiration of the 20-year term of the charitable lead interest, the foundation will have no interest whatsoever in the charitable lead trust."

The taxpayer points to a supposed fallacy in the regulation. Under the terms of the trust instrument, the foundation has the right to receive distributions of $[redacted] per year for the 20-year term. "Obviously, the foundation's interest decreases each year as the 20-year term draws closer to termination." The regulation, however, requires that the foundation add $[redacted] per year to its distributable amount (subject to a limitation that the amount not exceed 5 percent of the trust assets) in each year of the charitable interests' term, even though applying the annuity interest tables under the regulations in effect, the value of the foundation's right to receive $[redacted] declines, so that in the 19th year will be only $[redacted] Petitioner asserts that this result cannot be reconciled with the language of section 4942(d) and (e). You expect petitioner will make the same arguments (that the regulatory provision is invalid because it is broader than the underlying statute) to the Tax Court.

ANALYSIS

I.R.C. § 4942(a)(1) imposes a tax of 15 percent on the amount of a private non-operating foundation's undistributed income for any taxable year which has not been distributed before the first day of the second (or any succeeding) taxable year following such taxable year if such first day falls within the taxable period. I.R.C. § 4942(c) provides that the term undistributed income means with respect to any private foundation for any taxable year as of any time, the amount by which the distributable amount for such taxable year exceeds the qualifying distributions made before such time out of such distributable amount.

I.R.C. § 4942(d) defines the distributable amount to mean an amount equal to the sum of the minimum investment return plus the amounts described in I.R.C. § 4942(f)(2)(C) reduced by the sum of the taxes imposed on such private foundation for the taxable year under subtitle A and section 4940.[1] I.R.C. § 4942(e)(1) currently provides that in general the minimum investment return for any taxable year is 5 percent of the excess of the aggregate of all assets of the foundation other than those which are used directly in carrying out the foundation's exempt purpose, over the acquisition indebtedness with respect to such assets. [2]

I.R.C. 4942(g)(1) provides in pertinent part that the term qualifying distribution means any amount including that portion of reasonable and necessary administrative expenses paid to accomplish one or more purposes described in section 170(c)(2)(B) other than contributions to certain controlled organizations or to other private foundations except as provided in paragraph (3). I.R.C. § 4942(g)(3) provides that a contribution to certain controlled organizations or other private foundations will constitute a qualifying distribution if the recipient organization before the end of its next taxable year makes a qualifying distribution equal to the amount of such contribution which is treated as a distribution out of

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[1] As originally enacted in the Tax Reform Act of 1969, I.R.C. § 4942 provided that a private foundation had to make charitable distributions in an amount equal to the greater of its adjusted net income or its minimum investment return.

[2] As originally enacted, I.R.C. § 4942(e) provided that the minimum investment return was determined by multiplying the applicable percentage against value of the foundation's assets. The applicable percentage was specified by the Secretary of the Treasury or its delegate, with the rate for tax years beginning in 1970 being 6%. Congress struck the phrase "or the adjusted net income (whichever is higher)," from I.R.C. § 4942(d)(1) in 1981. Economic Recovery Tax Act of 1981, Pub. L. No. 97-34, 97th Cong., 1st Sess., section 823. In 1976, Congress had amended I.R.C. § 4942(e) to eliminate the Treasury's authority to set the applicable percentage and set the minimum investment return at its present figure of 5 percent. Tax Reform Act of 1976, Pub. L. No. 94-455, 94th Cong., 2d Sess., Section 1303; Jt. Comm. on Taxation, General Explanation of the Tax Reform Act of 1976, 394-396 (Dec. 29, 1976), 1976-3 (Vol. 2) C.B. 406-408.

corpus and the private foundation making the contribution obtains adequate records or other sufficient evidence showing that the qualifying distributions have in fact been made.

I.R.C. § 4947(a)(1) provides in pertinent part that in the case of a trust which is not exempt from tax under section 501(a), not all of the unexpired interests in which are not devoted to one or more of the purposes described in section 170(c)(2)(B), and which has amounts for which a deduction was allowed under sections 170, 545(b)(2), 556(b)(2), 642(c), 2055, 2106(a)(2) or 2522, section 507, section 508(e) to the extent applicable to a trust described in this paragraph, sections 4941, 4943, 4944 and 4945 shall apply to such trust as if the trust were a private foundation. This paragraph does not apply to any amounts payable under the terms of such trust to income beneficiaries unless a deduction was allowed under section 170(c)(2)(B), 2055(e)(2)(B) or 2522(c)(2)(B). I.R.C. § 4947(b)(1) provides that the Secretary shall prescribe such regulations as may be necessary to carry out the purposes of this section.

At issue in this case is whether the amounts the foundation receives from an I.R.C. § 4947(a)(c) charitable income trust are includible in the distributable amount under the regulation at issue. I.R.C. § 4942(d) provides that the distributable amount is the sum of the minimum investment return (plus subsection (f)(2)(C) amounts) less the sum of the taxes imposed on the foundation for the year under subtitle A and I.R.C. § 4940. I.R.C. § 4942(e)(1) provides in general that the minimum investment return is 5 percent of the excess of the aggregate fair market value of the foundation's assets excluding those used in carrying out the foundation's exempt purposes, over the acquisition indebtedness with respect to those assets. Treas. Reg § 53.4942(a)-2(b)(2) provides in part that the distributable amount shall be increased by the income portion from trusts described in section 4947(a)(2) subject to the limitation that the private foundation is not required to distribute an amount for such year had the corpus of the section 4947(a)(2) trust been taken into account as an asset of the foundation within the meaning of Treas. Reg. § 53.4942(a)-2(c)(1)(i). An examination of the legislative history of both sections 4942 and 4947, and certain Code provisions relating to the charitable contribution deductions for gifts in trust, is helpful in considering the regulation's validity.

I.R.C. § 4942 and 4947 were among a number of provisions enacted as part of the Tax Reform Act of 1969 relating to various exempt organizations and charitable contributions, including defining private foundations and enacting certain excise taxes (including that imposed by section 4942) to deter abuses by private foundations. Among the abuses found to exist was the problem of deferred benefits going to charity after a donor received a substantial charitable contribution deduction. The Treasury Department had recommended that private foundations be required to distribute to charity all net income on a relatively current basis, Treas. Dept. Studies and Proposals, 296 (1969), with which Congress agreed by enacting section 4942.

The Ways and Means Committee Report explained,

> Under present law, if a private foundation invests in assets that produce no current income, then it need make no distributions for charitable purposes. As a result, while the donor may receive substantial tax benefits from his contribution currently, charity may receive absolutely no current benefit. In other cases even though income is produced by the assets contributed to charitable organizations, distributions may not be required. In such circumstances, no current distribution is required until the accumulations become "unreasonable." Although a number of court cases have begun to set guidelines as to the circumstances under which an accumulation becomes unreasonable, in many cases the determination is essential subjective. Moreover, as in the case of self-dealing, it frequently happens that the only available sanction (loss of exempt status) either is largely ineffective or else is unduly harsh.

H.R. Rep. No. 91-413, 91st Cong., 1st Sess., 25; 1969-3 C.B. 200, 217.

To replace the existing law, Congress enacted I.R.C. § 4942. The House Report further stated,

> Under the bill, to avoid tax a private foundation must distribute currently all of its net income (including the excess of exempt income over the expenses of earning that interest), other than long-term capital gains. To prevent avoidance of the current-benefits-to-charity purpose of this provision by investments in growth stock or nonproductive land, the bill requires a foundation to pay out at least a specified percentage of its noncharitable assets.
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> For purposes of the minimum payout requirement, qualifying distributions include distributions to "public charities" and to private operating foundations, direct expenditures for charitable purposes, and expenditures for assets to be used in charitable purposes. A contribution to another private foundation is not forbidden, but (except in the case of a contribution to a

> private operating foundation) it may be made only in addition to qualified distributions that meet the minimum payout requirement.

H.R. Rep. at 25-26; 1969-3 C.B. at 217. See also S. Rep. No. 91-552, 91st Cong., 1st Sess. 34-36, 1969-3 C.B. 423, 446-447.

The Senate amended the House bill to permit foundations to treat as a qualifying distribution, distributions from one private foundation to another private foundation or to certain controlled section 501(c)(3) organizations but only if the recipient organization spent or used the funds within one year of receipt. The expenditure of such funds is in addition to the minimum expenditure requirement otherwise applicable to the recipient organization. S. Rep. No. 91-552 at 36- 37; 1969-3 C.B. at 448.

This Senate amendment was adopted in the final version of the Act. The Joint Committee on Taxation in its General Explanation of the Tax Reform Act of 1969 commented that, "[t]his permits an additional year's delay in the payout of funds into the stream of charitable expenditures. To limit any further delay, however, the donee organization is not permitted to pass such a grant through to another private operating foundation or to a controlled organization." Joint Committee on Taxation, General Explanation of the Tax Reform Act of 1969, 39 (December 3, 1970).

The Tax Reform Act of 1969 also included provisions that limited the deductibility of charitable contributions for gifts in trust under various provisions relating to the income, gift and estate taxes. The congressional purpose underlying these provisions was similar to the purpose underlying section 4942. These provisions appertained to the deduction allowance and valuation of gifts of income or remainder trust interests. Congress was concerned with charitable remainder trusts that the value of the charitable contribution deduction a taxpayer receives may bear little relation to the amount received by charity. Congress amended I.R.C. §§ 170(f), 2055(e), 2106(a) and 2522(c) to allow contributions of a remainder interest to charity that took specified forms, either an annuity trust or a unitrust. H.R. Rep. No. 91-413 at 58; 1969-3 C.B. 237; Sen. Rep. No. 91-552 at 87, 1969-3 C.B. 479.[3]

Charitable income trusts provided a slightly different problem. Under then existing law, a charitable deduction was allowed for an income interest to charity. Additionally, neither the taxpayer nor the trust was taxed on the income earned by the trust. The Senate Finance Committee explained the need for changes:

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[3] I.R.C. § 4947(a)(2) trusts are also not subject to I.R.C. § 4940, and in certain circumstances I.R.C. §§ 4943 and 4944. Treas. Reg. § 53.4940-1(d)(2), relating to the definition of gross investment income provides that, in general, a disbursement from a section 4947(a) trust shall not retain its character in the hands of the distributee for purposes of computing the section 4940 tax "except that, in the case of a distribution from a trust described in section 4947(a)(2), the income of such trust attributable to transfers in trust after May 26, 1969, shall retain its character in the hands of the distributee private foundation for purposes of section 4940 (unless such income is taken into account because of the application of section 671).

> A taxpayer receives a double tax benefit where he is allowed a charitable contribution deduction for the present value of an income interest in trust given to charity and also is not taxed on the income earned by the trust. In fact this double benefit allows a taxpayer to increase his after-tax cash position by postponing a planned noncharitable gift.

S. Rep. No. 91-552 at 92; 1969-3 C.B. at 482. See also H. Rep. No. 91-413 at 61, 1969-3 C.B. 238.

The Senate explained the provision as follows:

> Both versions of the bill provide that for income tax purposes a charitable deduction is not to be allowed for an income interest given to charity in trust, unless the grantor is taxable on the income of the trust or unless all interests in the trust are given to charity. The bill also provides that a charitable deduction is not to be allowed for income tax purposes for an income interest to charity in trust unless either the interest is in the form of a guaranteed annuity or the trust instrument specifies that the charitable-income beneficiary is to receive a fixed percentage annually of the fair market value of the trust property (as determined each year).
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> The purpose of the unitrust-annuity trust requirement is to assure that the amount received by the charity bears a reasonable correlation to the amount of the charitable deduction allowed the taxpayer.

S. Rep. No. 91-552 at 92-93, 1969-3 C.B. 483.

Congressional intent in enacting limitations on charitable contribution deductions for gifts in trust is similar to its intent in enacting the minimum distribution requirements for private foundations in section 4942. The purpose of the restrictions on deductions for trust interests was to prevent double tax benefits and to insure that the amount of the a charitable contribution deduction allowed would be equivalent to the benefit received by charity. Similarly, the purpose of the minimum distribution requirements was to ensure a relatively current benefit to charity commensurate with the tax benefits received on account of the tax deduction received by contributors.[4]

Prior to 1969, nonexempt trusts were not subjected to the restrictions imposed on certain exempt organizations. I.R.C. § 4947 was enacted to prevent the use of nonexempt trusts to avoid the restrictions on private foundations. The Senate Finance Committee Report noted that:

> If a nonexempt charitable trust were not subject to many of the requirements and restrictions imposed on private foundations, it would be possible for taxpayers to avoid these restrictions by the use of nonexempt trusts instead of private foundations. To forestall this possibility, the House bill generally imposed on nonexempt trusts the same requirements and restrictions which were made applicable to private foundations (... but not the current income payout requirement except where all of the interests in the trust are charitable).

S. Rep. No. 91-552 at 93-94; 1969-3 C.B. 483.

It is not disputed that the petitioner in this case is a private non-operating foundation and that the Trust is a split-interest trust under I.R.C. § 4947(a)(2). In addition to the charitable income interest, it has a noncharitable remainder interest. Furthermore, it has an amount in trust for which a deduction was allowed under I.R.C. § 2522 as a gift tax charitable deduction. While it is not subject to section 4942, petitioner is subject to sections 4941 and 4945, and probably sections 4943 and 4944. See I.R.C. § 4947(b)(3).

The rule stated in Treas. Reg. § 53.4942(a)-2(b)(2) was included in T.D. 7256, and has remained substantially unchanged for 17 years during which time the distribution requirement has been amended several times.[5] This provision had not been included in the proposed regulations for section 4942. Under the proposed regulations, if a foundation had

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[4] Congress also amended the charitable contribution deduction available to trusts under I.R.C. § 642(c), restricting the deduction in most cases to amounts paid out exclusively for section 170(c) purposes. Prior law allowed a deduction for amounts set aside for such purposes. For a fuller discussion of the impact of the Tax Reform Act of 1969 on nonexempt trusts, see Appert, Nonexempt Charitable Trusts Under the Tax Reform Act of 1969, 25 Tax Law. 99 (1971).

[5] As stated in footnote 2 supra, in 1976 Congress set the minimum investment return at 5 percent of the foundation's assets not used directly in exempt activities, and in 1981 eliminated the requirement that it distribute the adjusted net income when that amount exceeded the minimum investment return.

a present income interest in a section 4947(a)(2) trust, the assets to which such income was attributable would be included in the foundation's minimum investment income.[6]

After the proposed notice of rulemaking was promulgated, the Service received comments on the proposed regulations, including a number directed at this provision. This provision was also discussed by practitioners who acknowledged the need to prevent dilution of the minimum charitable distribution requirements, although some suggested other alternatives such as including distributions from split-interest trusts in a private foundation's adjusted net income. See, T. Kurz, *The Private Foundation Provisions: The Purpose and Effect of Sections 4941*, 4942, 4943, 31st Annual N.Y.U. Institute on Fed. Taxation, 1311, 1323-1325 (1973). The final regulations deleted the provision and inserted the provision at issue in this case. The technical memorandum[7] (copy enclosed) to the final regulations notes this change explaining:

> The amendment has been made for three reasons. First, since trust distributions are excluded from a foundation's adjusted net income as contributions, the only trust distributions which a foundation should be required to include in its distributable amount are distributions in situations where a grantor can use the creation of the trust as a means to avoid the tax imposed by section 4942. This exists in the case of a trust described in section 4947(a)(2). For example, assume that A, instead of transferring the shares he owns of the A Corporation to the B Foundation, creates a trust, using his shares in the A Corporation as the trust property, and the terms of the trust instrument provide that 99 percent of the trust income is payable to the B

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[6] As set forth in the Notice of Proposed Rulemaking published in the Federal Register on June 8, 1971 (36 Fed. Reg. 11034), Prop. Treas. Reg. §53.4942(a)-2(c)(ii)(e) provided:

> (ii) Certain Assets excluded. For purposes of this paragraph, the assets taken into account under section 4942(e)(1)(A)(i) shall not include the following:
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> (e) Any future interest (such as a vested or contingent remainder(of a foundation in the income or corpus of a trust described in section 4947(a)(2) until all intervening interest in, and rights to actual possession or enjoyment of, such income or corpus have expired (however, if a foundation has a current interest in a trust described in section 4947(a)(2), the assets to which such income is attributable shall be taken into account under section 4942(e)(1)(A)(i)).

[7] The technical memorandum is a public document which can be retrieved on Lexis. While we do not believe you should directly cite it as controlling authority, it plays a role in the evolution of the regulation and its rationale can be presented as the Service position to the court.

> Foundation, one percent to A for life, then to his children for life, with the remainder interest to the B. Foundation. A has created a trust described in section 4947(a)(2). If the amounts paid to B under these circumstances were treated as contributions excluded from B's distributable amount, A would be able to virtually eliminate the amount which B would be required to distribute for charitable purposes in order to avoid the tax imposed by section 4942. However, by treating the trust distribution as an amount taken into account in determining B's distributable amount, B will be required to distribute the total income derived from the trust.

While not stated in the rationale of the technical memorandum, the regulation also placed income distributions from section 4947(a)(2) trusts to a private foundation equivalently with a distribution from one private foundation to another. Under I.R.C. § 4942(g)(1)(A), distributions from a private foundation to another private foundation are not qualifying distributions unless the donee foundation makes a qualifying distribution of such amounts before the close of the first taxable year after its taxable year of receipt.

The technical memorandum indicates at page 9 that the authority for this provision is I.R.C. § 4947(b)(1) which provides that the Service shall prescribe such regulations as are necessary to carry out the purposes of section 4947. In challenging the validity of Treas. Reg. § 53.4942(a)-2(b)(2), petitioner has focused narrowly on the language of section 4942, and ignored its relationship to other private foundation provisions, and the Congressional intent in enacting section 4947 as well as the authorization contained in section 4947(b)(1) for the Service to promulgate the regulations necessary to carry out the purpose of section 4947, dealing with the use of non-exempt trusts to avoid the private foundation requirements. When the regulation is viewed in the context of all of the private foundation provisions, and in conjunction with the language and intent of section 4947, we believe that it serves as a reasonable interpretation of the statutory scheme, and its validity should be defended on that basis. While section 4947(b)(1) provides a specific grant of authority to promulgate regulations, Treas. Reg. § 53.4942(a)-2(b)(2) should not, in this case, be defended on the basis that it is a legislative regulation.[8]

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[8] Significantly, while I.R.C. § 4947(b)(1) provides a grant of authority for the promulgation of regulations to implement Congressional intent of preventing the avoidance of the private foundation rules by non-exempt charitable trusts and split-interest trusts, neither the notice of proposed rulemaking nor the final rule cited this section for authority in promulgating the regulation. Based on coordination with the Office of the Assistant Chief Counsel (Employee Benefits and Exempt Organizations), the office responsible for promulgation of Treas. Reg. §53.4942-2(b)(2), it was decided not to argue that the regulation at issue is a legislative regulation. In addition to our concerns whether the court would uphold this contention, we had serious concerns concerning the possibility the taxpayer might question whether promulgation of the regulation satisfied the Administrative Procedure Act (see

(continued...)

Authorization for rules and regulations under the Internal Revenue Code is provided in section 7805. Subsection (a) directs the Secretary of the Treasury to--

> prescribe all needful rules and regulations for the enforcement of this title, including all rules and regulations as necessary by reason of any alteration of law in relation to internal revenue.

Subsection (b) authorizes the Secretary to--

> prescribe the extent, if any, to which any ruling or regulation, relating to the internal revenue laws, shall be applied without retroactive effect.

In tax litigation determining the substantive validity of Treasury Regulations, the term "legislative" is used to describe regulations "issued under a specific grant of authority to define a statutory term or prescribe a method of executing a statutory provision." United States v. Vogel Fertilizer Co., 455 U.S. 16, 102 S.Ct. 821, 828 (1982). Regulations issued under the general authority of section 7805(a) are referred to as "interpretative" in Supreme Court opinions. Id.[9]

Petitioner's attack on the regulation rests on the assertion that the regulation is broader than the explicit language of the statute. However, when the language of the statute is examined in conjunction with its origin and purpose, we believe the regulation is a reasonable interpretation of sections 4942 and 4947. We acknowledge that the Service cannot impose restrictions on a taxpayer broader than allowed by statute in light of the intent of Congress and the purpose of the particular provision. For example in Estate of Boeshore v. Commissioner, 78 T.C. 523 (1982), the Tax Court held that Treas. Reg. § 20.2055-2(e)(2)(vi)(e) was invalid to the extent the regulation imposed restrictions on the allowable form of a charitable unitrust. The court noted that the legislative history indicated "the express intent of Congress to allow a charitable deduction for a gift of a charitable income interest so long as requirements for the form of the trust was met. Insofar as the

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[8](...continued)
American Medical Association v. United States, 887 F.2d 760 (7th Cir. 1989)). In view of these doubts, it was felt prudent that the Service not make the argument that the regulation is a legislative regulation.

[9] "Legislative" regulations are "as binding on a court as a statute" if "within the statute." Anderson Clayton & Co. v. United States, 562 F.2d 972 (5th Cir. 1977), cert. denied 436 U.S. 944. American Standard, Inc. v. United States, 602 F.2d 256 (Ct. Cl. 1979). Interpretative regulations will be sustained as reasonable and valid if they harmonize with a statute's language, origin and purpose. United States v. Vogel Fertilizer Co., 455 U.S. 16, 102 S.Ct. 821, 828 (1982); National Muffler Dealers Association v. United States, 440 U.S. 472, 476 (1979), 99 S.Ct. 1304 (1979) ("Interpretative" regulations are customarily upheld "if found to interpret the Congressional mandate in some reasonable manner").

regulation imposed additional restrictions which bore no relationship to possible abuse, the regulation exceeded the statute."

The instant case is distinguishable. While Congress did not subject split-interest trusts with charitable income interests to section 4942, such a requirement was unnecessary insofar as a charitable deduction would only be allowed for a gift in trust that was in one of the specified forms. Congress did define the minimum investment return in terms of the aggregate fair market value of all assets of the foundation other than assets used (or held for use) directly in carrying out the foundation's exempt purpose (I.R.C. § 4942(e)(1)). The term "assets" is not similarly defined. Given Congressional awareness (reflected in section 4947) that split-interest and taxable charitable trusts could be used to avoid the private foundation provisions, and given the lack of a more specific definition of the term asset, the rule adopted in the regulation, which has the effect of treating in a very limited manner the assets of a split-interest trust as assets of the private foundation, appears a reasonable rule to prevent circumvention of the private foundation provisions by split-interest trusts. Section 4942 was enacted to insure a current benefit to charity by private foundations, and requiring the flow-through of amounts received from split-interest trusts effectuates this purpose by preventing a taxpayer from receiving a substantial present tax benefit for a gift in trust to a private foundation, in excess to the present benefit to charity.

The facts of the present case indicate such an abuse. Here, [redacted] received a gift tax deduction of over $ [redacted] for a gift to a trust whose charitable beneficiary was a private foundation she controlled. If she had contributed the amount directly to the foundation, the foundation would have had to make charitable distributions considerably in excess of what the foundation argues it is required to make. At the same time, [redacted] was able to minimize the gift tax that would have to be paid on the gift of the remainder interests in the trust and at the expiration of the trust term the corpus of the trust, including any accumulated undistributed income, would pass to the holders of the remainder interests with a carryover in basis. In forcing the private foundation to make more substantial distributions, section 4942 insures a more current benefit to charity. As applied to these facts, the regulations clearly are a reasonable response consistent with Congressional intent. We are confident that the Service can prevail on this basis.

We also note that this is a longstanding regulation. Congress has changed the minimum distribution requirements several times after the final regulations were promulgated in 1973, and none of these changes indicated any Congressional disapproval of the regulation.[10] Accordingly, we suggest that on reply brief you assert that Congressional approval based on the doctrine of legislative reenactment. Helvering v. R.J. Reynolds Tobacco Co., 306 U.S. 110, 115 (1939); Mertens Law of Fed. Income Tax §3.62-3.65 (1990 rev.).

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[10] In addition to amendments as part of the Tax Reform Act of 1976 and the Economic Recovery Tax Act of 1981, the Tax Reform Act of 1984 also made certain technical amendments to the distribution requirements.

Accordingly, we recommend you defend this case on the basis discussed above. If you have any questions or need further assistance, please contact Ronald Weinstock at FTS 566-3345.

MARLENE GROSS
Assistant Chief Counsel
(Tax Litigation)

By: ______________________
HENRY G. SALAMY
Chief, Branch No. 4
Tax Litigation Division

Enclosure:
As stated